

**Senate Bill No. 1234**

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Passed the Senate      September 9, 1997

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*Secretary of the Senate*

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Passed the Assembly      September 4, 1997

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*Chief Clerk of the Assembly*

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This bill was received by the Governor this \_\_\_\_ day  
of \_\_\_\_\_, 1997, at \_\_\_\_ o'clock \_\_M.

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*Private Secretary of the Governor*

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## CHAPTER \_\_\_\_

An act to amend Sections 17009, 17039, 17941, 18633.5, 23036, and 23038 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

## LEGISLATIVE COUNSEL'S DIGEST

SB 1234, Alpert. Personal Income Tax Law: Bank and Corporation Tax Law: corporations and limited liability companies: classification.

The Personal Income Tax Law imposes, for each taxable year beginning on or after January 1, 1997, a specified tax upon limited liability companies doing business in this state. For purposes of this tax, a “limited liability company” is defined to mean an organization that is, among other things, classified as a partnership for California tax purposes.

This bill would eliminate this portion of the definition of a limited liability company and instead include in that definition that the entity is not taxable as a corporation. This bill would eliminate related provisions with respect to tax liability. This bill would, as provided, also require each limited liability company that is disregarded for tax purposes pursuant to specified provisions of the Bank and Corporation Tax Law to file a return containing specified information.

The Personal Income Tax Law and the Bank and Corporation Tax Law each generally specifies certain limitations and requirements with respect to the application of credits against the taxes imposed under those laws.

This bill would, for purposes of both of these laws, specify certain additional limits on the application and carryover of credit amounts with respect to any taxpayer that owns a business entity that is disregarded for tax purposes under specified provisions of the Bank and Corporation Tax Law.

The Personal Income Tax Law defines a “corporation” to include, among other entities, business trusts.



This bill would also include within that definition other business entities taxable as a corporation under regulations of the Franchise Tax Board.

The Bank and Corporation Tax Law defines the term “corporation” to exclude banks and include associations, excluding banking associations and including nonprofit associations that perform services, borrow money, or own property, and Massachusetts or business trusts, as defined.

This bill would instead define the term “corporation” to include banks, unless specifically provided otherwise. This bill would also define the term “corporation,” for income and taxable years beginning on or after January 1, 1997, to exclude banking associations and to include associations, as provided, business trusts, and other business entities that are classified under regulations, as provided, of the Franchise Tax Board as associations taxable as corporations.

This bill would incorporate additional changes in Section 18633.5 of the Revenue and Taxation Code, proposed by SB 1106, to be operative only if SB 1106 and this bill are both chaptered and become effective on or before January 1, 1998, and this bill is chaptered last.

This bill would incorporate additional changes in Section 23038 of the Revenue and Taxation Code, proposed by AB 1040, to be operative only if AB 1040 and this bill are both chaptered and become effective on or before January 1, 1998, and this bill is chaptered last.

This bill would take effect immediately as a tax levy.

*The people of the State of California do enact as follows:*

SECTION 1. Section 17009 of the Revenue and Taxation Code is amended to read:

17009. “Corporation” includes joint stock companies or associations (including nonprofit associations that perform services, borrow money or own property, and business trusts or other business entities taxable as a corporation under regulations of the Franchise Tax Board) and insurance companies. “Corporation” also



includes a trust organized and operated exclusively for purposes contained in Section 23701d.

SEC. 2. Section 17039 of the Revenue and Taxation Code is amended to read:

17039. (a) Notwithstanding any provision in this part to the contrary, for the purposes of computing tax credits, the term “net tax” means the tax imposed under either Section 17041 or 17048 plus the tax imposed under Section 17504 (relating to lump-sum distributions) less the credits allowed by Section 17054 (relating to personal exemption credits) and any amount imposed under paragraph (1) of subdivision (d) and paragraph (1) of subdivision (e) of Section 17560. Notwithstanding the preceding sentence, the “net tax” shall not be less than the tax imposed under Section 17504 (relating to the separate tax on lump-sum distributions), if any. Credits shall be allowed against “net tax” in the following order:

(1) Credits that do not contain carryover or refundable provisions, except those described in paragraphs (4) and (5).

(2) Credits that contain carryover provisions but do not contain refundable provisions.

(3) Credits that contain both carryover and refundable provisions.

(4) The minimum tax credit allowed by Section 17063 (relating to the alternative minimum tax).

(5) Credits for taxes paid to other states allowed by Chapter 12 (commencing with Section 18001).

(6) Credits that contain refundable provisions but do not contain carryover provisions.

The order within each paragraph shall be determined by the Franchise Tax Board.

(b) Notwithstanding the provisions of Sections 17053.5 (relating to the renter’s credit), 17061 (relating to refunds pursuant to the Unemployment Insurance Code), and 19002 (relating to tax withholding), the credits provided in those sections shall be allowed in the order provided in paragraph (6) of subdivision (a).

(c) (1) Notwithstanding any other provision of this part, no tax credit shall reduce the tax imposed under



Section 17041 or 17048 plus the tax imposed under Section 17504 (relating to the separate tax on lump-sum distributions) below the tentative minimum tax, as defined by Section 17062, except the following credits, but only after allowance of the credit allowed by Section 17063:

(A) The credit allowed by former Section 17052.4 (relating to solar energy).

(B) The credit allowed by former Section 17052.5 (relating to solar energy).

(C) The credit allowed by Section 17052.5 (relating to solar energy).

(D) The credit allowed by Section 17052.12 (relating to research expenses).

(E) The credit allowed by former Section 17052.13 (relating to sales and use tax credit).

(F) The credit allowed by Section 17052.15 (relating to Los Angeles Revitalization Zone sales tax credit).

(G) The credit allowed by Section 17053.5 (relating to the renter's credit).

(H) The credit allowed by former Section 17053.8 (relating to enterprise zone hiring credit).

(I) The credit allowed by Section 17053.10 (relating to Los Angeles Revitalization Zone hiring credit).

(J) The credit allowed by former Section 17053.11 (relating to program area hiring credit).

(K) For each taxable year beginning on or after January 1, 1994, the credit allowed by Section 17053.17 (relating to Los Angeles Revitalization Zone hiring credit).

(L) The credit allowed by Section 17053.49 (relating to qualified property).

(M) The credit allowed by Section 17053.70 (relating to enterprise zone sales or use tax credit).

(N) The credit allowed by Section 17053.74 (relating to enterprise zone hiring credit).

(O) The credit allowed by Section 17057 (relating to clinical testing expenses).

(P) The credit allowed by Section 17058 (relating to low-income housing).



(Q) The credit allowed by Section 17061 (relating to refunds pursuant to the Unemployment Insurance Code).

(R) Credits for taxes paid to other states allowed by Chapter 12 (commencing with Section 18001).

(S) The credit allowed by Section 19002 (relating to tax withholding).

(2) Any credit that is partially or totally denied under paragraph (1) shall be allowed to be carried over and applied to the net tax in succeeding taxable years, if the provisions relating to that credit include a provision to allow a carryover when that credit exceeds the net tax.

(d) Unless otherwise provided, any remaining carryover of a credit allowed by a section that has been repealed or made inoperative shall continue to be allowed to be carried over under the provisions of that section as it read immediately prior to being repealed or becoming inoperative.

(e) (1) Unless otherwise provided, if two or more taxpayers (other than husband and wife) share in costs that would be eligible for a tax credit allowed under this part, each taxpayer shall be eligible to receive the tax credit in proportion to his or her respective share of the costs paid or incurred.

(2) In the case of a partnership, the credit shall be allocated among the partners pursuant to a written partnership agreement in accordance with Section 704 of the Internal Revenue Code, relating to partner's distributive share.

(3) In the case of a husband and wife who file separate returns, the credit may be taken by either or equally divided between them.

(f) Unless otherwise provided, in the case of a partnership, any credit allowed by this part shall be computed at the partnership level, and any limitation on the expenses qualifying for the credit or limitation upon the amount of the credit shall be applied to the partnership and to each partner.

(g) (1) With respect to any taxpayer that directly or indirectly owns an interest in a business entity that is



disregarded for tax purposes pursuant to Section 23038 and any regulations thereunder, the amount of any credit or credit carryforward allowable for any taxable year attributable to the disregarded business entity shall be limited in accordance with paragraphs (2) and (3).

(2) The amount of any credit otherwise allowed under this part, including any credit carryover from prior years, that may be applied to reduce the taxpayer's "net tax," as defined in subdivision (a), for the taxable year shall be limited to an amount equal to the excess of the taxpayer's regular tax (as defined in Section 17062), determined by including income attributable to the disregarded business entity that generated the credit or credit carryover, over the taxpayer's regular tax (as defined in Section 17062), determined by excluding the income attributable to that disregarded business entity. No credit shall be allowed if the taxpayer's regular tax (as defined in Section 17062), determined by including the income attributable to the disregarded business entity, is less than the taxpayer's regular tax (as defined in Section 17062), determined by excluding the income attributable to the disregarded business entity.

(3) If the amount of a credit allowed pursuant to the section establishing the credit exceeds the amount allowable under this subdivision in any taxable year, the excess amount may be carried over to subsequent taxable years pursuant to subdivisions (c) and (d).

SEC. 3. Section 17941 of the Revenue and Taxation Code is amended to read:

17941. (a) For each taxable year beginning on or after January 1, 1997, every limited liability company doing business in this state (as defined in Section 23101) shall pay annually to this state a tax for the privilege of doing business in this state in an amount equal to the applicable amount specified in paragraph (1) of subdivision (d) of Section 23153 for the taxable year.

(b) In addition to any limited liability company which is doing business in this state and is therefore subject to the tax imposed by subdivision (a), for each taxable year beginning on or after January 1, 1997, a limited liability



company shall pay annually the tax prescribed in subdivision (a) if articles of organization have been accepted, or a certificate of registration has been issued, by the office of the Secretary of State. The tax shall be paid for each taxable year, or part thereof, until a certificate of cancellation of registration or of articles of organization is filed on behalf of the limited liability company with the office of the Secretary of State.

(c) The tax assessed under this section shall be due and payable on or before the 15th day of the fourth month of the taxable year.

(d) For purposes of this section, “limited liability company” means any organization that is formed by one or more persons under the law of this state, any other country, or any other state, as a “limited liability company” and that is not taxable as a corporation for California tax purposes.

SEC. 4. Section 18633.5 of the Revenue and Taxation Code is amended to read:

18633.5. (a) Every limited liability company which is classified as a partnership for California tax purposes that is doing business in this state, organized in this state, or registered with the Secretary of State shall file its return within three months and 15 days after the close of its taxable year, shall make a return for that taxable year, stating specifically the items of gross income and the deductions allowed by Part 10 (commencing with Section 17001). The return shall include the names, addresses, and taxpayer identification numbers of the persons, whether residents or nonresidents, who would be entitled to share in the net income if distributed and the amount of the distributive share of each person. The return shall contain or be verified by a written declaration that it is made under the penalties of perjury, signed by one of the limited liability company members.

(b) Each limited liability company required to file a return under subdivision (a) for any limited liability company taxable or income year shall, on or before the day on which the return for that taxable or income year was required to be filed, furnish to each person who holds





an interest in that limited liability company at any time during that taxable year a copy of that information required to be shown on that return as may be required by forms and instructions prescribed by the Franchise Tax Board.

(c) Any person who holds an interest in a limited liability company as a nominee for another person shall do both of the following:

(1) Furnish to the limited liability company, in the manner prescribed by the Franchise Tax Board, the name, address, and taxpayer identification number of that person, and any other information for that taxable or income year as the Franchise Tax Board may prescribe by forms and instructions.

(2) Furnish to that other person, in the manner prescribed by the Franchise Tax Board, the information provided by that limited liability company under subdivision (b).

(d) The provisions of Section 6031(d) of the Internal Revenue Code, relating to the separate statement of items of unrelated business taxable income, shall apply.

(e) (1) A limited liability company shall file with its return required under subdivision (a), in the form required by the Franchise Tax Board, the agreement of each nonresident member to file a return pursuant to Section 18501, to make timely payment of all taxes imposed on the member by this state with respect to the income of the limited liability company, and to be subject to personal jurisdiction in this state for purposes of the collection of income taxes, together with related interest and penalties, imposed on the member by this state with respect to the income of the limited liability company. If the limited liability company fails timely to file the agreements on behalf of each of its nonresident members, then the limited liability company shall, at the time set forth in subdivision (f), pay to this state on behalf of each nonresident member of whom an agreement has not been timely filed an amount equal to the highest marginal tax rate in effect under Section 17041 in the case of members which are individuals, estates, or trusts, and



Section 23151 in the case of members which are corporations, multiplied by the amount of the member's distributive share of the income source to the state reflected on the limited liability company's return for the taxable period. A limited liability company shall be entitled to recover the payment made from the member on whose behalf the payment was made.

(2) If a limited liability company fails to attach the agreement or to timely pay the payment required by paragraph (1), the payment shall be considered the tax of the limited liability company for purposes of the penalty prescribed by Section 19132 and interest prescribed by Section 19101 for failure to timely pay tax. Payment of the penalty and interest imposed on the limited liability company for failure to timely pay the amount required by this subdivision shall extinguish the liability of a nonresident member for the penalty and interest for failure to make timely payment of all taxes imposed on that member by this state with respect to the income of the limited liability company.

(3) No penalty or interest shall be imposed on the limited liability company under paragraph (2) if the nonresident member timely files and pays all taxes imposed on the member by this state with respect to the income of the limited liability company.

(f) Any agreement of a nonresident member required to be filed pursuant to subdivision (e) shall be filed at either of the following times:

(1) The time the annual return is required to be filed pursuant to this section for the first taxable period for which the limited liability company became subject to tax pursuant to Chapter 1.6 (commencing with Section 23091).

(2) The time the annual return is required to be filed pursuant to this section for any taxable period in which the limited liability company had a nonresident member on whose behalf the agreement has not been previously filed.

(g) Any amount paid by the limited liability company to this state pursuant to paragraph (1) of subdivision (e)



shall be considered to be a payment by the member on account of the income tax imposed by this state on the member for the taxable period.

(h) Every limited liability company that is classified as a corporation for California tax purposes shall be subject to the requirement to file a tax return under the provisions of Part 10.2 (commencing with Section 18401) and the applicable taxes imposed by Part 11 (commencing with Section 23001) including Section 23221 relating to the prepayment of the minimum tax to the Secretary of State.

(i) (1) Every limited liability company doing business in this state, organized in this state, or registered with the Secretary of State, that is disregarded pursuant to Section 23038 shall file a return that includes information necessary to verify its liability under Sections 17941 and 17942, provides its sole owner's name and taxpayer identification number, includes the consent of the owner to California tax jurisdiction, and includes other information necessary for the administration of this part, Part 10 (commencing with Section 17001), or Part 11 (commencing with Section 23001).

(2) If the owner's consent required under paragraph (1) is not included, the limited liability company shall pay on behalf of its owner an amount consistent with, and treated the same as, the amount to be paid under subdivision (e) by a limited liability company on behalf of a nonresident member for whom an agreement required by subdivision (e) is not attached to the return of the limited liability company.

(3) The return required under paragraph (1) shall be filed within three months and 15 days after the close of the taxable or income year of the owner.

(4) For limited liability companies disregarded pursuant to Section 23038, "taxable or income year of the owner" shall be substituted for "taxable year" in Sections 17941 and 17942.

SEC. 4.5. Section 18633.5 of the Revenue and Taxation Code is amended to read:



18633.5. (a) Every limited liability company which is classified as a partnership for California tax purposes that is doing business in this state, organized in this state, or registered with the Secretary of State shall file its return within three months and 15 days after the close of its taxable year, shall make a return for that taxable year, stating specifically the items of gross income and the deductions allowed by Part 10 (commencing with Section 17001). The return shall include the names, addresses, and taxpayer identification numbers of the persons, whether residents or nonresidents, who would be entitled to share in the net income if distributed and the amount of the distributive share of each person. The return shall contain or be verified by a written declaration that it is made under the penalties of perjury, signed by one of the limited liability company members. In the case of a limited liability company not doing business in this state, and subject to the tax imposed by subdivision (b) of Section 17941 or 23091, the Franchise Tax Board shall, for returns required to be filed on or after January 1, 1998, prescribe the manner and extent to which the information identified in this subdivision shall be included with the return required by this subdivision.

(b) Each limited liability company required to file a return under subdivision (a) for any limited liability company taxable or income year shall, on or before the day on which the return for that taxable or income year was required to be filed, furnish to each person who holds an interest in that limited liability company at any time during that taxable or income year a copy of that information required to be shown on that return as may be required by forms and instructions prescribed by the Franchise Tax Board.

(c) Any person who holds an interest in a limited liability company as a nominee for another person shall do both of the following:

(1) Furnish to the limited liability company, in the manner prescribed by the Franchise Tax Board, the name, address, and taxpayer identification number of that person, and any other information for that taxable or



income year as the Franchise Tax Board may prescribe by forms and instructions.

(2) Furnish to that other person, in the manner prescribed by the Franchise Tax Board, the information provided by that limited liability company under subdivision (b).

(d) The provisions of Section 6031(d) of the Internal Revenue Code, relating to the separate statement of items of unrelated business taxable income, shall apply.

(e) (1) A limited liability company shall file with its return required under subdivision (a), in the form required by the Franchise Tax Board, the agreement of each nonresident member to file a return pursuant to Section 18501, to make timely payment of all taxes imposed on the member by this state with respect to the income of the limited liability company, and to be subject to personal jurisdiction in this state for purposes of the collection of income taxes, together with related interest and penalties, imposed on the member by this state with respect to the income of the limited liability company. If the limited liability company fails to timely file the agreements on behalf of each of its nonresident members, then the limited liability company shall, at the time set forth in subdivision (f), pay to this state on behalf of each nonresident member of whom an agreement has not been timely filed an amount equal to the highest marginal tax rate in effect under Section 17041, in the case of members which are individuals, estates, or trusts, and Section 23151, in the case of members which are corporations, multiplied by the amount of the member's distributive share of the income source to the state reflected on the limited liability company's return for the taxable period. A limited liability company shall be entitled to recover the payment made from the member on whose behalf the payment was made.

(2) If a limited liability company fails to attach the agreement or to timely pay the payment required by paragraph (1), the payment shall be considered the tax of the limited liability company for purposes of the penalty prescribed by Section 19132 and interest



prescribed by Section 19101 for failure to timely pay the tax. Payment of the penalty and interest imposed on the limited liability company for failure to timely pay the amount required by this subdivision shall extinguish the liability of a nonresident member for the penalty and interest for failure to make timely payment of all taxes imposed on that member by this state with respect to the income of the limited liability company.

(3) No penalty or interest shall be imposed on the limited liability company under paragraph (2) if the nonresident member timely files and pays all taxes imposed on the member by this state with respect to the income of the limited liability company.

(f) Any agreement of a nonresident member required to be filed pursuant to subdivision (e) shall be filed at either of the following times:

(1) The time the annual return is required to be filed pursuant to this section for the first taxable period for which the limited liability company became subject to tax pursuant to Chapter 1.6 (commencing with Section 23091).

(2) The time the annual return is required to be filed pursuant to this section for any taxable period in which the limited liability company had a nonresident member on whose behalf an agreement described in subdivision (e) has not been previously filed.

(g) Any amount paid by the limited liability company to this state pursuant to paragraph (1) of subdivision (e) shall be considered to be a payment by the member on account of the income tax imposed by this state on the member for the taxable period.

(h) Every limited liability company that is classified as a corporation for California tax purposes shall be subject to the requirement to file a tax return under the provisions of Part 10.2 (commencing with Section 18401) and the applicable taxes imposed by Part 11 (commencing with Section 23001) including Section 23221 relating to the prepayment of the minimum tax to the Secretary of State.



(i) (1) Every limited liability company doing business in this state, organized in this state, or registered with the Secretary of State, that is disregarded pursuant to Section 23038 shall file a return that includes information necessary to verify its liability under Sections 17941 and 17942, provides its sole owner's name and taxpayer identification number, includes the consent of the owner to California tax jurisdiction, and includes other information necessary for the administration of this part, Part 10 (commencing with Section 17001), or Part 11 (commencing with Section 23001).

(2) If the owner's consent required under paragraph (1) is not included, the limited liability company shall pay on behalf of its owner an amount consistent with, and treated the same as, the amount to be paid under subdivision (e) by a limited liability company on behalf of a nonresident member for whom an agreement required by subdivision (e) is not attached to the return of the limited liability company.

(3) The return required under paragraph (1) shall be filed within three months and 15 days after the close of the taxable or income year of the owner.

(4) For limited liability companies disregarded pursuant to Section 23038, "taxable or income year of the owner" shall be substituted for "taxable year" in Sections 17941 and 17942.

SEC. 5. Section 23036 of the Revenue and Taxation Code is amended to read:

23036. (a) (1) The term "tax" includes any of the following:

(A) The tax imposed under Chapter 2 (commencing with Section 23101).

(B) The tax imposed under Chapter 3 (commencing with Section 23501).

(C) The tax on unrelated business taxable income, imposed under Section 23731.

(D) The tax on S corporations imposed under Section 23802.

(2) The term "tax" does not include any amount imposed under paragraph (1) of subdivision (e) of

Section 24667 or paragraph (2) of subdivision (f) of Section 24667.

(b) For purposes of Article 5 (commencing with Section 18661) of Chapter 2, Article 3 (commencing with Section 19031) of Chapter 4, Article 6 (commencing with Section 19101) of Chapter 4, and Chapter 7 (commencing with Section 19501) of Part 10.2, and for purposes of Sections 18601, 19001, and 19005, the term “tax” shall also include all of the following:

(1) The tax on limited partnerships, imposed under Section 17935 or Section 23081, the tax on limited liability companies, imposed under Section 17941 or Section 23091, and the tax on registered limited liability partnerships and foreign limited liability partnerships imposed under Section 17948 or Section 23097.

(2) The alternative minimum tax imposed under Chapter 2.5 (commencing with Section 23400).

(3) The tax on built-in gains of S corporations, imposed under Section 23809.

(4) The tax on excess passive investment income of S corporations, imposed under Section 23811.

(c) Notwithstanding any other provision of this part, credits shall be allowed against the “tax” in the following order:

(1) Credits that do not contain carryover provisions.

(2) Credits that, when the credit exceeds the “tax,” allow the excess to be carried over to offset the “tax” in succeeding taxable years. The order of credits within this paragraph shall be determined by the Franchise Tax Board.

(3) The minimum tax credit allowed by Section 23453.

(4) Credits for taxes withheld under Section 18662.

(d) Notwithstanding any other provision of this part, each of the following shall be applicable:

(1) No credit shall reduce the “tax” below the tentative minimum tax (as defined by paragraph (1) of subdivision (a) of Section 23455), except the following credits, but only after allowance of the credit allowed by Section 23453:





(A) The credit allowed by former Section 23601 (relating to solar energy).

(B) The credit allowed by former Section 23601.4 (relating to solar energy).

(C) The credit allowed by Section 23601.5 (relating to solar energy).

(D) The credit allowed by Section 23609 (relating to research expenditures).

(E) The credit allowed by Section 23609.5 (relating to clinical testing expenses).

(F) The credit allowed by Section 23610.5 (relating to low-income housing).

(G) The credit allowed by former Section 23612 (relating to sales and use tax credit).

(H) The credit allowed by Section 23612.2 (relating to enterprise zone sales or use tax credit).

(I) The credit allowed by Section 23612.6 (relating to Los Angeles Revitalization Zone sales tax credit).

(J) The credit allowed by former Section 23622 (relating to enterprise zone hiring credit).

(K) The credit allowed by Section 23622.7 (relating to enterprise zone hiring credit).

(L) The credit allowed by former Section 23623 (relating to program area hiring credit).

(M) For each income year beginning on or after January 1, 1994, the credit allowed by Section 23623.5 (relating to Los Angeles Revitalization Zone hiring credit).

(N) The credit allowed by Section 23625 (relating to Los Angeles Revitalization Zone hiring credit).

(O) The credit allowed by Section 23649 (relating to qualified property).

(2) No credit against the tax shall reduce the minimum franchise tax imposed under Chapter 2 (commencing with Section 23101).

(e) Any credit which is partially or totally denied under subdivision (d) shall be allowed to be carried over to reduce the “tax” in the following year, and succeeding years if necessary, if the provisions relating to that credit

include a provision to allow a carryover of the unused portion of that credit.

(f) Unless otherwise provided, any remaining carryover from a credit that has been repealed or made inoperative shall continue to be allowed to be carried over under the provisions of that section as it read immediately prior to being repealed or becoming inoperative.

(g) Unless otherwise provided, if two or more taxpayers share in costs that would be eligible for a tax credit allowed under this part, each taxpayer shall be eligible to receive the tax credit in proportion to its respective share of the costs paid or incurred.

(h) Unless otherwise provided, in the case of an S corporation, any credit allowed by this part shall be computed at the S corporation level, and any limitation on the expenses qualifying for the credit or limitation upon the amount of the credit shall be applied to the S corporation and to each shareholder.

(i) (1) With respect to any taxpayer that directly or indirectly owns an interest in a business entity that is disregarded for tax purposes pursuant to Section 23038 and any regulations thereunder, the amount of any credit or credit carryforward allowable for any income year attributable to the disregarded business entity shall be limited in accordance with paragraphs (2) and (3).

(2) The amount of any credit otherwise allowed under this part, including any credit carryover from prior years, that may be applied to reduce the taxpayer's "tax," as defined in subdivision (a), for the income year shall be limited to an amount equal to the excess of the taxpayer's regular tax (as defined in Section 23455), determined by including income attributable to the disregarded business entity that generated the credit or credit carryover, over the taxpayer's regular tax (as defined in Section 23455), determined by excluding the income attributable to that disregarded business entity. No credit shall be allowed if the taxpayer's regular tax (as defined in Section 23455), determined by including the income attributable to the disregarded business entity is less than the taxpayer's



regular tax (as defined in Section 23455), determined by excluding the income attributable to the disregarded business entity.

(3) If the amount of a credit allowed pursuant to the section establishing the credit exceeds the amount allowable under this subdivision in any income year, the excess amount may be carried over to subsequent income years pursuant to subdivisions (d), (e) and (f).

SEC. 6. Section 23038 of the Revenue and Taxation Code is amended to read:

23038. (a) “Corporation” includes every corporation except corporations expressly exempt from the tax by this part or the Constitution of this state.

(b) (1) For the purposes of the tax imposed under Chapter 3 (commencing with Section 23501), “corporation” also includes associations (including nonprofit associations that perform services, borrow money or own property), other than banking associations, and Massachusetts or business trusts. For the purposes of this part, a Massachusetts or business trust includes every business organization consisting essentially of an arrangement whereby property is conveyed to one, or more than one, trustee for purposes other than the mere conservation of assets, collecting and disbursing of fixed or periodic income, or the securing of an obligation. This paragraph shall apply for income or taxable years beginning before January 1, 1997.

(2) (A) For the purposes of the tax imposed under Chapter 3 (commencing with Section 23501), “corporation” also includes associations (other than banking associations but including nonprofit associations that perform services, borrow money or own property), business trusts, and other business entities classified as associations.

(B) (i) For purposes of the preceding subparagraph, the classification of a business entity (including a business trust) as an association taxable as a corporation (under Chapter 3 (commencing with Section 23501)) shall be determined under regulations of the Franchise Tax Board, which shall be consistent with federal regulations



as in effect January 1, 1997, that classify a business entity as a partnership or an association taxable as a corporation or disregard the separate existence of certain business entities for tax purposes.

(ii) The classification of an eligible business entity as a partnership or an association taxable as a corporation for purposes of this part, Part 10 (commencing with Section 17001), and Part 10.2 (commencing with Section 18401) shall be the same as the classification of the entity for federal tax purposes.

(iii) If the separate existence of an eligible business entity is disregarded for federal tax purposes, the separate existence of that business entity shall be disregarded for purposes of this part, Part 10 (commencing with Section 17001), and Part 10.2 (commencing with Section 18401), other than Section 17941 (relating to the tax of a limited liability company), Section 17942 (relating to the fee of a limited liability company), Section 18633.5 (relating to the return of a limited liability company), and Sections 17039 and 23036 (relating to tax credits).

(C) Notwithstanding clauses (ii) and (iii) of subparagraph (B), an eligible business entity that, for any income year beginning within the 60-month period preceding January 1, 1997, was properly classified as an association taxable as a corporation for California tax purposes shall continue to be an association taxable as a corporation until it elects, under regulations issued pursuant to subparagraph (B), to be classified or disregarded the same as the entity is classified or disregarded for federal tax purposes. The preceding sentence shall not apply to any entity that, during the 60-month period preceding January 1, 1997, was not doing business in this state, did not derive income from sources within this state, and had no owner who was a resident of this state.

(D) This paragraph shall apply for income or taxable years beginning on and after January 1, 1997.

(c) In addition to the above, for purposes of the tax imposed under Chapter 2 (commencing with Section 23101) for the purpose of exercising its franchise within



this state, “corporation” also includes any limited liability company that is classified as an association for California tax purposes.

(d) “Corporation” includes any “corporation” operated by any receiver, liquidator, referee, trustee or other officers or agents appointed by any court, or an assignee for the benefit of creditors.

“Corporation” includes any professional corporation incorporated pursuant to Part 4 (commencing with Section 13400) of Division 3 of Title 1 of the Corporations Code.

(e) Notwithstanding the above, “corporation” also includes a trust organized and operated exclusively for purposes contained in Section 23701d.

(f) No provision of the act adding this subdivision shall be construed to alter existing law with respect to the civil liability of a limited liability company or its members.

SEC. 6.5. Section 23038 of the Revenue and Taxation Code is amended to read:

23038. (a) “Corporation” includes every corporation except:

(1) Banks.

(2) Corporations expressly exempt from the tax by this part or the Constitution of this state.

(b) (1) For the purposes of the tax imposed under Chapter 3 (commencing with Section 23501), “corporation” also includes associations (including nonprofit associations that perform services, borrow money or own property), other than banking associations, and Massachusetts or business trusts. For the purposes of this part, a Massachusetts or business trust includes every business organization consisting essentially of an arrangement whereby property is conveyed to one, or more than one, trustee for purposes other than the mere conservation of assets, collecting and disbursing of fixed or periodic income, or the securing of an obligation. This paragraph shall apply for income or taxable years beginning before January 1, 1997.

(2) (A) For the purposes of the tax imposed under Chapter 3 (commencing with Section 23501),



“corporation” also includes associations (other than banking associations but including nonprofit associations that perform services, borrow money, or own property), business trusts, and other business entities classified as associations.

(B) (i) For purposes of the preceding subparagraph, the classification of a business entity (including a business trust) as an association taxable as a corporation (under Chapter 3 (commencing with Section 23501)) shall be determined under regulations of the Franchise Tax Board, which shall be consistent with federal regulations as in effect January 1, 1997, that classify a business entity as a partnership or an association taxable as a corporation or disregard the separate existence of certain business entities for tax purposes.

(ii) The classification of an eligible business entity as a partnership or an association taxable as a corporation for purposes of this part, Part 10 (commencing with Section 17001), and Part 10.2 (commencing with Section 18401) shall be the same as the classification of the entity for federal tax purposes.

(iii) If the separate existence of an eligible business entity is disregarded for federal tax purposes, the separate existence of that business entity shall be disregarded for purposes of this part, Part 10 (commencing with Section 17001), and Part 10.2 (commencing with Section 18401), other than Section 17941 (relating to the tax of a limited liability company), Section 17942 (relating to the fee of a limited liability company), Section 18633.5 (relating to the return of a limited liability company), and Sections 17039 and 23036 (relating to tax credits).

(C) Notwithstanding clauses (ii) and (iii) of subparagraph (B), an eligible business entity that, for any income year beginning within the 60-month period preceding January 1, 1997, was properly classified as an association taxable as a corporation for California tax purposes shall continue to be an association taxable as a corporation until it elects, under regulations issued pursuant to subparagraph (B), to be classified or disregarded the same as the entity is classified or



disregarded for federal tax purposes. The preceding sentence shall not apply to any entity which, during the 60-month period preceding January 1, 1997, was not doing business in this state, did not derive income from sources within this state, and had no owner who was a resident of this state.

(D) This paragraph shall apply for income or taxable years beginning on and after January 1, 1997.

(c) In addition to the above, for purposes of the tax imposed under Chapter 2 (commencing with Section 23101) for the purpose of exercising its franchise within this state, “corporation” also includes any limited liability company that is classified as an association for California tax purposes.

(d) “Corporation” includes any “corporation” operated by any receiver, liquidator, referee, trustee or other officers or agents appointed by any court, or an assignee for the benefit of creditors.

“Corporation” includes any professional corporation incorporated pursuant to Part 4 (commencing with Section 13400) of Division 3 of Title 1 of the Corporations Code.

(e) Notwithstanding the above, “corporation” also includes a trust organized and operated exclusively for purposes contained in Section 23701d.

(f) No provision of the act adding this subdivision shall be construed to alter existing law with respect to the civil liability of a limited liability company or its members.

SEC. 7. Section 4.5 of this bill incorporates amendments to Section 18633.5 of the Revenue and Taxation Code proposed by both this bill and SB 1106. It shall only become operative if (1) both bills are enacted and become effective on or before January 1, 1998, (2) each bill amends Section 18633.5 of the Revenue and Taxation Code, and (3) this bill is enacted after SB 1106, in which case Section 18633.5 of the Revenue and Taxation Code as amended by SB 1106 shall remain operative only until the operative date of this bill, at which time Section 4.5 of this bill shall become operative, and Section 4 of this bill shall not become operative.



SEC. 8. (a) Section 6 of this bill incorporates amendments to Section 23038 of the Revenue and Taxation Code proposed by both this bill and AB 1040. It shall only become operative if (1) both bills are enacted and become effective on or before January 1, 1998, (2) each bill amends Section 23038 of the Revenue and Taxation Code, and (3) this bill is enacted after AB 1040, in which case Section 6.5 of this bill shall remain operative only until the effective date of AB 1040, at which time Section 6 of this bill shall become operative.

(b) If Section 6 of this bill becomes operative, both of the following shall apply:

(1) The amendments made to Section 23038 of the Revenue and Taxation Code by AB 1040 shall be applied from the original effective date of the act enacting Section 23038 of the Revenue and Taxation Code. The Legislature finds and declares that the amendments made to Section 23038 of the Revenue and Taxation Code by AB 1040 are consistent with the intent of the act enacting that section.

(2) The amendments made to Section 23038 of the Revenue and Taxation Code only by this bill shall be operative for income years beginning on or after January 1, 1997.

SEC. 9. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.





Approved \_\_\_\_\_, 1997

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*Governor*

